Deindustrialisation and Reindustrialisation

SOUTH AFRICAN
Presidential Economic Advisory Council

DEINDUSTRIALISATION AND REINDUSTRIALISATION
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1. WHY IS DEINDUSTRIALISATION A POLICY CONCERN?

- Industrialisation has long been regarded as the key path for developing countries to attain sustained rates of high growth and catch up with advanced economies.
- Importance of structural change – shift in the composition of GDP and employment towards higher-productivity activities – which is associated with industrialisation.
- Manufacturing has long been regarded as a special engine of growth, due to inter-related characteristics that are associated more strongly with manufacturing than with other sectors:
  - Ability to absorb large numbers of less skilled workers;
  - Absence of demand-side constraints due to exportability;
  - Strong forward and (especially) backward linkages - able to pull along other sectors;
  - Superior scope for cumulative productivity increases (i.e. productivity increases that build on and feed into one another);
  - Strong unconditional convergence in labour productivity in (formal) manufacturing - potential for catching up;
  - Manufacturing exports are important in alleviating balance of payments constraints;
  - Dynamic increasing returns to scale in manufacturing;
  - Learning-by-doing (at worker, firm and sector levels)
    - Suggests that deindustrialisation is likely to have negative effects on growth.
- International evidence suggests that deindustrialisation can also worsen inequality, poverty, social cohesion etc.
- Premature deindustrialisation, which is already in progress in developing countries, is a particular concern
  - When deindustrialisation sets in at lower levels of income per capita and lower shares of manufacturing in GDP and employment, less of the benefits of industrialisation will have been captured and it is less viable for services to act as an alternative engine of growth.

2. TAKING ACCOUNT OF THE COMPLEXITY OF DEINDUSTRIALISATION IN THE CURRENT PERIOD

- Considerable heterogeneity within sectors
  - some services, agricultural and other activities have stronger growth-pulling properties than some manufacturing activities;
• growth is activity-specific as well as-sector specific;
• while manufacturing still ‘matters’, not all manufacturing matters to the same extent, and some non-manufacturing activities also ‘matter’ a lot.

Increasing ‘fuzziness’ of sector boundaries and integration between sectors.
Employment-deindustrialisation seems to be a universal phenomenon, but the trends in output-deindustrialisation are more variegated:
• Some of this is the shifting around of global manufacturing towards East Asia (as distinct from a global decline in manufacturing);
• Some of apparent deindustrialisation is just a reclassification of activities associated with outsourcing from manufacturing to services;
• While most countries of the world are deindustrialising, some countries are managing to avoid or reverse this;
• The trends are very different for sub-sectors of manufacturing – e.g. for high-tech manufacturing there is no evidence of ‘deindustrialisation’ even with higher income per capita.

3. THE SOUTH AFRICAN CONTEXT

• There has been deindustrialisation over a long period of time, perhaps since the early 1980s, especially as a share of total employment.
• There does not appear to be a shift into high-productivity services that could potentially act as an alternative engine of growth.
• There is a mismatch between the skilled workforce that much of the manufacturing sector increasingly needs, and the low skills levels among most of the unemployed.
• South Africa is lagging in the use of 4IR technologies in manufacturing, which can erode our competitiveness going forward.
• Difficulty of growing manufacturing in global context of competition from countries (notably China) that have low unit labour costs relative to their levels of technological advancement.
• Globally, there is strongest growth potential in high-tech manufacturing and least in low-tech manufacturing. And although high-tech manufacturing is less labour-intensive than low-tech manufacturing, there is still greater employment growth potential even with rising income per capita.
• Challenge for South Africa of growing high-tech manufacturing while creating large-scale employment.
• There has been poor co-ordination among policy domains that directly affect manufacturing
(industrial policy, macroeconomic policy, education and skills development, innovation and technology policy, trade policy, etc.).

• The current scale of industrial policy insufficient to avoid, let alone, to reverse, deindustrialisation.

4. POLICY IMPLICATIONS

There are several important questions associated with an industrialisation agenda, that policymakers need to grapple with. These include:

• **How viable is it to grow manufacturing in South Africa in the current era?**
  There is a challenge of achieving reindustrialisation where possible (including for specific sub-sectors of manufacturing and specific regions of the country), and at the least slowing, managing and mitigating deindustrialisation. One thing that is clear is that, without decisive policy interventions, the current deindustrialisation trends are bound to continue. While some success in output terms might be possible, the prospects for increasing the employment share of manufacturing – which is what South Africa really needs to achieve inclusive growth – would not seem as strong.

• **The challenge of (re)industrialisation in the context of the need to reduce emissions**
  Historically, there have generally been higher emissions (per unit of value added) in industry than in agriculture or services. This poses a challenge of reconciling industrialisation with mitigating climate change. It is worth noting that both the composition of manufacturing matters (for example, high-tech manufacturing is generally cleaner than low-tech, and the nature of manufacturing technologies and processes also affect the extent of emissions. That is, there is scope for reducing the emissions associated with any given level of manufacturing production.

• **Which sub-sectors of manufacturing to prioritise?**
  With our low growth rates and crisis of unemployment, South Africa ideally needs activities that have strong growth-pulling properties as well as activities that are strongly labour-absorbing (including of low-skilled labour). While this is not a binary choice – there are activities that are both growth-pulling and labour-absorbing (especially when taking into account employment multipliers through intersectoral linkages) – there are trade-offs, including in which sectors to prioritise for support.
There are no easy answers to these questions. And as with all policy decisions, there are choices and trade-offs involved.

In broad terms, some policy implications and suggestions include:

• In light of the heterogeneity within sectors, it is important not just to look at sectors overall – policy also needs to be directed at the sub-sectoral level (e.g. in terms of which types of activities to incentivise).

• If industrial policy is to more effectively support manufacturing growth, there needs to be much better integration with other policy domains. In particular, improved co-ordination with macroeconomic policy: austere macroeconomic policy (especially high interest rates and an uncompetitive exchange rate) will inevitably hamper any industrialisation efforts.

• Industrial policy needs to be scaled up and better resourced in order to have a significant impact in supporting industrialisation and ultimately in raising employment and growth. One aspect of this is the need for supporting a mixture of both growth-pulling sub-sectors (which could be relatively high-tech and high-productivity) and those that are crucial for absorbing low-skilled labour.

• Specific industrial policy measures are beyond the scope of this policy brief. However, we would underscore the importance of both interventions to promote firm-level productive capabilities (production and technological capabilities to innovate, export etc.) at the micro-level, as well as ensuring that, at the macro-level, there is sufficient capital investment in manufacturing. The PEAC will engage further on specific industrial policy measures.

• There is a need for a much sharper focus on addressing the mismatch between the dominant skills profile of those who need jobs and the types of skills that manufacturing increasingly needs. While there is already widespread acceptance of the general need for skills development and improvements in the education system, we need:
  • more targeted short- and medium-term skills development measures to address particular skills constraints on manufacturing growth
  • support for the types of manufacturing activities that make relatively intensive use of low-skilled workers.

• There is a need to maximise the employment creation potential of manufacturing, including through the promotion of some low-productivity activities that are important for employment creation, including of low-skilled labour, taking into account not only direct employment but also indirect labour absorption.
There are both threats and opportunities to manufacturing associated with the imperative of mitigating climate change and the renewable energy transition. Industrial policy needs to support:

- the production of the types of manufactures that generate less emissions ('what is produced');
- production technologies and processes that generate less emissions ('how it is produced')
- building capabilities and competitiveness in producing goods and technologies that will be in increasing demand internationally, associated with the green transition. That is, shifting South Africa from being a follower (and likely importer) closer towards leading countries in manufacturing goods such as solar panels, at least in certain niche areas in which we have the potential to build dynamic comparative advantage and have export potential. If South Africa is to take up the opportunities associated with ‘green’ manufacturing, then we need to move much faster.

- It is critical for industrial policy to promote sub-sectors and activities outside manufacturing that have the types of properties traditionally associated with manufacturing.
- In line with the previous point, an important question is whether ‘industrial’ policies may need to be re-directed towards employment-absorbing service sectors that exhibit relatively high productivity (examples might be tourism, call centres, others?).
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